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WHAT PROPERTIES SHOULD BE EXEMPT FROM TAXATION

BY JOHN J. MURPHY,

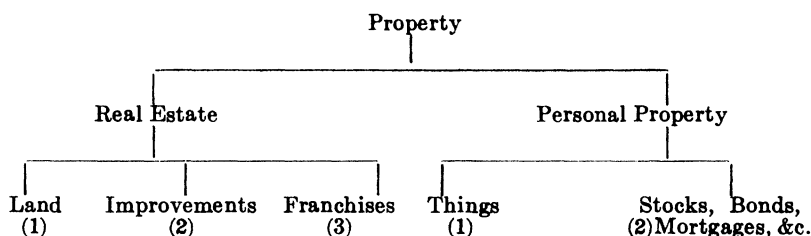
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City of New York.

The question as submitted is one of great scope because it involves the consideration of sources of national, state and local taxation. It is obviously impossible to treat within the scope of a single article of moderate length the various subjects comprised in so wide a field. Free trade and protection, prohibition and license, would be involved in any discussion which attempted to include the entire range of taxation.

Personally, I think it can be shown that most of the subjects of taxation now levied upon by state and national governments are improper bases, if for no other reason than that they are indirect, and that as the people do not know that they pay taxes on them at all, public interest in governmental economy is reduced to the minimum. In a world where most people find the aid of illusion necessary to make life tolerable, it is not wonderful that statesmen resort to devious devices in order to make taxation acceptable to taxpayers. Especially in democracies, is it true that tax legislation follows the line of least resistance, which always is to impose the tax upon someone who can shift it to another, in the form of increased prices, in such fashion that the apparent taxpayer knows that he is not actually paying the tax while the actual taxpayer does not know that he pays at all.

I will confine this article, therefore, to the consideration of what properties should be exempt from taxation for local purposes.

For purposes of local taxation, property is divided into real estate (which includes land, improvements thereon and franchises), and personal property (which includes tangibles and intangibles, the latter term being applied to evidences of ownership which may represent either realty or personal property). If we use the form of a genealogical chart we get a result somewhat as follows:



It will be seen at once that there is an inconsistency in this analysis because the second division of personal property consists chiefly of interests in some form of real estate. Hence if the real estate were fully and fairly taxed in the first place, taxation of mere ownership would be double taxation.

It will generally be admitted that that form of taxation is most desirable which lays the smallest burden upon industry, which least discourages saving and which can be most cheaply and certainly adjusted and collected.

There seems to be a consensus among those who have most intelligently studied the subject that personal property should be exempt, because taxation of it offends every one of the principles of desirable taxation laid down in the foregoing paragraph. There are still a few belated champions of the taxation of personal property even among metropolitan journals but it hardly seems worth while to waste space in refuting their arguments. All our older states have tried at one time or another to raise taxes in this way, only to confess failure. The law inevitably became inoperative and only left a feeling of injustice in the minds of the few persons who were its inevitable victims.

If personal property be eliminated as a proper subject for taxation there only remains real estate. The question arises here whether all the components of real estate are equally desirable as subjects of taxation. Franchises are special privileges granted to corporations or individuals to collect taxes in return for certain actual or nominal services rendered to private citizens. They only have a surplus value when such corporations or individuals are permitted to charge a rate for services rendered which is more than sufficient to pay all charges and the prevailing rate of interest on capital invested. As long as such surplus earnings are permitted, they seem to be proper subjects of taxation, but it would seem a

wiser and fairer policy to limit the rates, which franchise corporations are permitted to charge, to cost of production plus interest.

The subject of the exemption of improvements on real estate has engaged much public attention. One of the wisest men who has written on the subject, Enoch Enslee, a large land owner of Tennessee, affirmed that a wise community would not tax anything of value "which would come to you if it were not taxed but which would leave you if it were."

Most cities are confronted with the problem of providing adequate and sanitary housing accommodations for their poorer citizens. In Europe this problem assumed such proportions that only a municipal housing policy could meet the situation. Yet these cities were at the same time heavily taxing private citizens who were engaged in providing houses similar to those which the municipality was erecting at greater expense. It would seem obvious that every city should encourage to the utmost the expenditure of money in judicious construction. The more buildings there are, other things being equal, the lower the rents which citizens will have to pay. While there may be sporadic cases of over-building, as a general proposition, business judgment may be counted upon to check excessive development in that direction.

It would seem therefore that it would be good public policy, partially or wholly, to exempt buildings. It is frequently urged that to do so would be to place a premium upon enormous buildings, but it seems to me a sufficient answer that the existing system which does attempt to tax such buildings according to their full value, does not prevent this admitted evil. On the contrary it seems to encourage it; paradoxical as it may seem, it is quite possible that the exemption of buildings by putting a heavier tax upon sites, and thereby compelling a more general and uniform development, will prevent what is becoming one of the worst evils in our larger cities.

There is another point of view from which partial or total exemption of buildings would work out relief to enterprising owners. Business waxes and wanes. At one time there may be prosperity with large profits which makes the payment of taxation upon buildings a matter of moderate moment. At another time business is stagnant and the returns on property do not enable the owner to meet his obligations. Then taxation may be a crushing burden. There is an instance in Massachusetts of a mill, which, owing to in-

dustrial developments in other parts of the country, fell into disuse for a considerable period. For a number of years its owner was obliged to pay taxes on the building at a rate only slightly less than when the business was in operation. After doing this for four or five years he blew it up in order to save this annual expenditure. Later, had it not been destroyed, it could have been used.

It is sometimes urged that it would not be fair to absolve owners of buildings from paying their quota of taxes, that they consume public services and therefore ought to pay for them. I think, however, it is now generally admitted by economists that the lot value measures more accurately than the building can the value of the public services rendered in the vicinity, and that hence lot value is a better measure of the amount which the owner ought to pay than the building can be.

That the policy of exemption of factories, mills, etc., is regarded as "good business" is shown by a number of cases in which, sometimes legally, sometimes illegally, the taxing bodies of the smaller towns and villages hold out nominal taxation or exemption as an inducement to new industries to settle there. Such a policy is of course unjust to their older residents and ultimately opens the way to the creation of special privileges, always to be deplored in the relations between the municipality and the citizens.

To recapitulate, taxation of personal property is condemned by the best authorities and discredited by the experience of such bodies as have attempted to enforce it. It puts a premium on dishonesty and encourages favoritism. These faults are not the defects of administration but are inherent vices. It takes from the citizen property in the creation of which the state or municipality has had no hand. For these reasons, and others which it would take too long to enumerate, I believe it should be exempt from taxation.

In regard to real estate, the improvements on real estate are much more of the nature of personal property, in that they are direct products of human labor, than is the land, which is the other element that goes to make up real estate. It is in the public interest that the production of such improvements should be encouraged and not repressed. Exemption of housing would go a much longer way than any program of municipal housing to improve the living conditions of the poorer citizens. I feel, therefore, with

due deliberation, that is the direction which tax reform ought to take.

Of course, the effect of such a change of policy would be far-reaching and the change should be introduced slowly and with due regard for the welfare of the community as a whole. It is not so much a question of the distance which we travel as of the direction in which we shall move.